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Remarks of Larry F. Darby  
Establishing an Independent Regulatory Body for Telecommunications  
at a  
Workshop Sponsored by the USAID PEG Project<sup>1</sup> and the  
Ministry of Communications, Republic of Indonesia  
May 9, 2001

Thank you. I am very pleased to be invited by the Communications Ministry to share my views on an Independent Regulatory Body to encourage investment and promote development of telecommunication infrastructure and services in Indonesia.

The independent regulatory body (IRB) and how it is established can advance the development of the national economy and help increase the standard of living for the Indonesian people. If it is not correctly established and operated, the IRB also has the potential to slow down the development of communications infrastructure, to delay service and to hamper the rate of economic growth. The stakes for the Indonesian economy are very high and success will help Indonesians enjoy the benefits of the New Information Economy.

The new Telecommunications Law sets forth several goals and objectives. These goals involve such complex and important issues like creating infrastructure, assisting universal service, establishing and regulating competition, restructuring industry, attracting investment, issuing licenses, managing the radio spectrum, setting tariffs and others. This is a very ambitious agenda.

Indonesians have different views about how best to achieve the goals and directions of the new Law, but none is more critical than the debate that is now taking place about the IRB. For the IRB will assure that these issues are resolved in ways that are fair, open and contribute to the well-being of the people of Indonesia.

There is much to discuss and many issues to resolve. I cannot address them all, but will this morning ask and try to answer five basic questions. These are:

1. Why should Indonesia establish an independent regulatory body?

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<sup>1</sup> The Partnership for Economic Growth (PEG) is a USAID-funded Project with the Government of Indonesia. The views expressed in this report are those of the author and not necessarily those of USAID, the U.S. Government or the Government of Indonesia.

2. What is the meaning of “independent”?
3. How Can “independence“ be achieved?
4. What are the responsibilities of the IRB?
5. How does IRB relate to industry, parliament, the Ministry of Communications?

## **1. Why should Indonesia create an independent regulatory body?**

The answer is in several parts.

The new Telecommunications Law allows formation of such a regulatory body to carry out its main provisions. Specifically, Act number 36 of 1999 concerning telecommunications establishes overall policy objectives for telecommunications in Indonesia and sets forth several specific responsibilities:

- >prohibition of monopoly practices,
- >fair and efficient spectrum and operator licensing,
- >infrastructure expansion,
- >promotion of “universal service”,
- >ensure full and fair interconnection,
- >provide for cost-based rates and nondiscriminatory tariffs,
- >create more choices for consumers,
- >make provision of “special” telecommunications and others.

Specific responsibility for administering the Law is assigned to the Minister of Transportation and Telecommunications as the accountable party and provides that these regulations must give legal protection to investors, telecommunications operators and telecommunications users. These goals must be balanced carefully.

The Law recognizes that these regulations entail policy making, regulating, supervising and controlling new and existing telecommunications entities and that regulating, control and supervision can be delegated to a regulatory body, but it does not spell out specific terms of reference for such a body – its establishment; its specific powers and responsibilities; its composition; its role vis-a-vis the Ministry with responsibility for telecommunications; its procedures; and in general its specific statutory obligations.

I will address these matters in more detail in the next few minutes.

Why does Indonesia need a regulator? Indonesia is not alone in that pursuit. From 1990 to 2000, the number of regulators grew along with privatization and liberalization of the kind contemplated in the New Telecommunications Law. Over that ten year period, the number of regulatory bodies grew from 12 to 96. More are being considered in other countries while Indonesia is deciding about an IRB.

A regulator is needed to assure that communications industries act in the national interest. You might ask why we just do not depend on the managers of private firms to do that. The answer is that there is a divergence of industry goals and public goals. National policy and private interests are not the same. Thus, we need regulator to assure development of national policy that will attract capital.

An authority is needed to set the rules of the game, to make sure all follow the rules and to resolve disputes among competitors, users, suppliers and government interests. A regulatory body is needed to “level the playing field” between new, small companies and economically and politically powerful incumbents.

Regulation is needed to assure operation for good of all citizens, not just a few. The goal of regulation is to advance the public interest, which is the sum of all individual interests – rich/poor, young/old, urban/rural, user or producer or labor or supplier. All interests – economic, political, social, and individual -- should be weighed and protected in controlling communications firms with market power.

The IRB is the instrument for carrying out these goals.

Communications is different from other industries.

Communications is especially important to economic development

Communications is especially important to social development

Communications is especially important to political development.

Information is power. Access to information is important to the exercise of economic and political power. Regulation through an IRB can insure that this power is distributed fairly and not for just a few.

Communications business tends to monopoly. Some parts of it are a natural monopoly. Regulation is needed to protect users of monopoly services. Interests of users and operators are not the same. Shareholders want high prices and high

profits. Users want low prices. Users want innovation and risk taking, operators with market power want security and safety. Firms want to be the only choice; users like many choices. Businesses and consumers vary in many ways. The IRB can require operators with market power to serve the public, not just their managers and owners.

Thus, the IRB must do several things.

It should encourage full and fair competition.

It should prevent unfair or destructive discrimination.

It should promote universal service.

It should promote efficiency in the use of costly and scarce capital.

It should insist on improvements in service quality.

Very importantly, the IRB will enable the government to make credible and enduring commitments about the economic rules of the game in the marketplace. The IRB must ensure that the rules are stable; clear; and reasonable.

Government/regulatory commitments establish the framework for market competition -- the “rules of the game” and thereby influence investment through impact on risk, returns and growth. Commitments must be:

- >Well defined; understandable
- >Durable and sufficient to allow recovery of capital investment
- >Subject to “consensual” change through known and transparent processes – processes that are known and understood by all.

I have left the most important reason for last. An IRB is needed to attract, encourage and protect investment. The IRB can encourage investment by making clear both risks and opportunities; by making the ground rules openly and fairly; and, by assuring investors that their investments will be welcome and respected.

The telecommunications sector has two characteristics that make the sector extremely risky for investors.

- 1) Investment returns and risks in telecommunications depend heavily on government rules. At the same time, telecommunications is highly regulated in all countries of the world, even in the United States where the regulatory role of government has been reduced as much as possible.
- 2) Telecommunications is extremely capital intensive and usually yields a positive return on investment only many years after the initial investment.

As a result of these two factors, investments in the telecommunications sector are subject to a high degree of regulatory risk. This is the risk that regulations may change and thereby lead to lower returns before investors can recover their money.

In both developed and developing countries, huge amounts of capital are needed to build-out networks and to adopt existing networks to rapidly changing technologies. This is particularly the case in Indonesia, which has one of the lowest teledensities in Asia. In order to reduce regulatory risk and thereby increase investment, many countries have, or are in the process, of establishing *independent* regulatory bodies for telecommunications.

The IRB will reduce uncertainty and attract investment for entrants and established operators alike.

## 2. What is the meaning of “Independent” Regulatory Body?

I have had many discussions over the past year in Indonesia with experts inside and outside the government about the new Telecommunications Law and what needs to be done to advance telecommunications in Indonesia.

There is much agreement, some disagreement and many questions. That is to be expected.

One of the most important areas of question and uncertainty is the meaning of Independent. What is the meaning of independent? In the context of discussing the regulatory body, independence has several meanings. Let me suggest three guiding principles.

Principle # 1. The regulatory body should not be controlled by the companies that are being regulated. Nor should it be controlled by any user group or by suppliers or by consumers or by any “special interest group” It should be responsive to all of them, but independent of each. This “independence” ensures that the decisions of the regulatory body are not biased toward one company or another or in favor of one group. The regulatory body must be seen to be fair and making decisions based on the good for all the public, not just a few.

Principle # 2. The regulatory body should be independent of day-to-day political pressures. Communications policy must be not be “volatile” that is changing with every change in the political situation. Stability of the rules is

critical. If investors are to make long-term commitments of their wealth, they must be assured that the rules will not change quickly with changes in the political situation. They must also be assured that rule changes will come only after a fair hearing or rulemaking process. Otherwise they will invest in other sectors or in other countries.

Principle # 3. Decision authority within the regulatory body should be independent of any single individual. Decision making power within the body should be shared by more than one individual. This also ensures more stability, predictability and reliability in the regulatory process.

“Independence” does not mean that the regulatory body is separate from government. In all APEC countries, for example, telecommunications regulatory bodies are part of government and are staffed by civil servants.

Nor does “independence” mean unaccountable. An independent regulatory body, as part of government, is accountable to the highest levels of government, which ensures that the IRB is performing its work in accordance with the Law. The IRB is accountable to the Courts for enforcing the law; to the Parliament for its budget; and, ultimately, to the opinion of the people.

Related to the question of independence is the notion of transparency. Several factors are implied by the notion of transparency -- that is seeing into regulatory processes. For example, transparency implies:

- >All information on which decisions are made are a matter of public record
- >Equal opportunity for all interest groups to have their views considered
- >Regulator “accountability” – full and clear explanation for bases of decisions
- >Decision processes are publicly known

Independence and transparency can be achieved in a variety of ways. Typical characteristics of a regulatory body with a high degree of independence are:

- > Decisions of the regulatory body are final and are not subject to approval by other parts of government. However, such decisions are subject to judicial review in order to ensure that they conform with the law. As indicated above, a regulatory body is also accountable to the highest levels of government.

> In those countries where a Ministry has responsibility for state-owned telecommunications companies, these responsibilities should be clearly distinguished from regulatory functions. There is an inherent and very serious conflict of interest between being majority owner of a monopoly provider while simultaneously attempting to regulate it in the public interest. Investors are keenly aware of this conflict. Thus, for so long as the dominant operator is owned by government, it is imperative that the regulatory body be separate from the Ministry and the operator. This is the best way to eliminate the conflict of interest.

> Final decision authority of the regulatory body rests with three or more commissioners (or Board Members). In countries with a high degree of independence, the President, with approval (advice and consent) of the Legislature, is responsible for appointing commissioners.

> Commissioners serve fairly lengthy terms (e.g., five years) and can only be terminated because of death, conviction of a crime, resignation, illness, malfeasance, etc. This ensures that commissioners cannot be dismissed simply because their decisions are politically unpopular. An example of this type of position in Indonesia is the “Governor of Bank Indonesia.”

> To have even greater stability in the regulatory process, terms of the commissioners can be staggered so that only one new commissioner is appointed per year.

Let me quickly address some more specific questions that have been posed to me. Several approaches are of course possible and my purpose is to identify them.

### **How might or should the agency be created?**

- Direct election
- Presidential appointment
- Parliamentary appointment
- Combination – executive appoints, parliament approves

### **To whom are the regulatory body and its membership responsible?**

- President
- Parliament
- Carrying out the law, subject to judicial or other external review



**How many members should there be?**

1 (UK) to 5(US) or more

Number of members impact

Risk, diversity, time, political neutrality

Odd number best, if one person one vote/majority rule is adopted

**What should be the term length?**

Staggered terms

If independent of government, then terms can be any length – suggest five years for five person agency; new member every year and total turnover every five years

**Should seats be designated for particular parties or interests?**

In the best of all worlds, the IRB membership should be chosen on nonpolitical basis. The IRB should be as apolitical, nonpartisan as is possible. Seats on the IRB should not be “tagged” or “earmarked” for any particular political or interest group. This will help ensure both independence and transparency.

**Should there be other special qualifying characteristics for IRB membership?**

Good sense and judgment, high integrity, committed to public, not special, interest. An example of an Indonesian independent agency with the above characteristics is the Business Competition Supervisory Committee that was recently established under Indonesia’s “Law on the Prohibition of Monopolistic Practices and Unfair Business Competition.”

**4. What are the responsibilities of the IRB?**

An independent regulator should be staffed by technical experts who implement regulatory policies within the guidelines set forth in a country’s telecommunications law. Parliament makes the policy; the IRB should make the rules to carry out that policy.

These experts should have skills in technology and engineering, in law, in economics and accounting, in administration and management, in diplomacy, negotiating and others. The regulatory body should also have several different powers, including the power:

> to collect economic data

- > to investigate, do special studies of policy impacts
- > to conduct hearings,
- > to levy fines and revoke licenses,
- > to refer matters to the courts for criminal and civil prosecutions, and
- > to refer matters to other agencies such as anti-monopoly commission.

Examples of policies in Indonesia's Telecommunications Law of 1999 which might be handled by an independent regulator are:

- > Allocation of radio frequencies for commercial use;
- > Licensing telecommunications operators;
- > Establishing interconnection rates/rules and tariffs for dominant telecommunications operators;
- > Administering universal service obligations;
- > Setting standards and monitoring compliance;
- > Performing other regulatory functions as indicated in the Law, such as those pertaining to consumer protection and monopolistic practices.

If an independent regulatory body is established in Indonesia, rulemaking and enforcement responsibilities for the above policies would be transferred to the regulatory body.

It is important for the IRB to strike the correct balance between regulating and not regulating; that is balancing between government control and market control. The IRB must resist regulating too much, just as it must resist regulating too little. Government control should be imposed only for clearly stated purposes and where markets will not work satisfactorily. The power to regulate should be used in full awareness that improper government action can slow the rate of investment and innovation in telecom infrastructure and information services.

The IRB should:

- > Determine what firms and activities to regulate and which not to regulate
- > Limit regulation to operators with substantial market power
- > Regulate monopoly, let market forces regulate new entrants

## 5. How should the IRB relate to industry, parliament, the Ministry?

The Ministry would still retain broad control over telecommunications policy, management of government frequencies, government procurement of telecommunications equipment, representing the government in international forums (Intelsat, ITU, APEC, etc.), and coordination of government-sponsored

research and development.

Several questions have been raised about the relationship of the new IRB and other parts of the government. One suggestion is that the Ministry would retain:

- > Responsibility for expressing overall policy views of government
- > Spectrum management responsibilities for government frequencies  
Defense, public safety, governmental systems
- > Standard setting – coordinating new and old technology, equipment and systems
- > Government procurement of networks, systems and equipment
- > Coordinate government telecom related R and D
- > Represent government and lead delegations to international fora  
Intelsat, ITU, APEC, etc.

The Independent Regulatory Body would be responsible for:

- > Regulating business conduct of monopoly
- > Managing competition policy
- > Managing commercial spectrum

The IRB would could share responsibility for:

- > National security concerns in commercial networks
- > Mergers and acquisitions (with the Antimonopoly Commission)

I should emphasize that there are many workable models of IRBs now being used in various parts of the world. None is perfect and some are better than others. But all reflect the unique characteristics and history and culture and political institutions of individual countries. Indonesia is in a position to be able to adopt the best practices of regulatory bodies from all over the world. Several different institutional forms can succeed; there is no perfect model. But, successful regulatory programs have:

- > Well understood and durable restraints on regulatory discretion
- > Constraints on ability to change regulatory privileges and obligations
- > Presence of strong institutions for enforcing above
- > Enforceable commitment; judicial review; international harmony

## Conclusion

I have covered a lot of issues this morning. My intention has been to provoke your thoughts and to encourage open discussion. As I said out the outset, these are difficult and important questions for you to answer. And the stakes are high.

If I could leave you with only one thought, I would ask you always to keep in mind the target; the goal; the main reason why we are all discussing liberalization and regulatory reform in Indonesia. The reason is to create an economic and political environment that will encourage and welcome investment into this important sector. For without investment in network facilities and infrastructure, none of the promises of information and communications technology will be available to Indonesians.

Accelerating investment in telecommunications infrastructure is necessary for accelerating economic growth; and, a regulatory body of the kind I have described this morning is necessary to foster that investment. It is that simple, and that complicated.

I am available answer your questions and to participate in the rest of the program. Thank you again for having me and giving me this time to share my views on these very important questions.